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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 180.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Petitioner-Appellant.

vs.

R. P. CLARK, *Respondent-Appellee.*

On Writ of Certiorari to the Court of Appeals of the District of Columbia.

BRIEF FOR RESPONDENT.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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BRIEF FOR RESPONDENT.

Opinions Below.

The opinion of the Court of Appeals of the District of Columbia (R. 27) is reported in 59 Fed. (2d) 1031. The opinion of the Board of Tax Appeals (R. 15-17) is reported in 19 B. T. A. 859.

Jurisdiction.

The judgment of the Court of Appeals was entered April 11, 1932. Petition for Writ of Certiorari was filed on June 27, 1932, and granted on October 10, 1932. Jurisdiction is conferred upon this Court by Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Statutes Involved.

Revenue Act of 1921, c. 136, 42 Stat. 227, 231.

> Sec. 204. (a) That as used in this section the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery and other capital assets, used in the conduct of such trade or business); * * *
>
> (b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

Question Presented.

Were the net losses sustained in 1921 and 1922 by Respondent Clark, which he seeks to forward and deduct in 1923, net losses "resulting from the operation of any trade or business regularly carried on" by him, within the meaning of Section 204 of the Revenue Act of 1921?

Statement of the Case.

1. The controversy relates to the income and profits tax liability of the respondent, R. P. Clark, for the calendar year 1923. For the calendar year 1921, he sustained a net loss of $17,768.51. For the calendar year 1922 he sustained a net loss of $4,985.18. The respondent sought to deduct the two net losess from his income for 1923 but was denied that privilege by the Commissioner of Internal Revenue

on the ground that they were not net losses resulting from a trade or business regularly carried on by him. On appeal the Board of Tax Appeals sustained the Commissioner, but the Court of Appeals of the District of Columbia reversed the Board, and this Court is now asked to review and reverse or affirm the Court of Appeal's decision.

2. Respondent is a resident of Miami, Florida, and since 1888 has been engaged in river and harbor improvement work, dredging, and jetty building operations. From 1899 he was associated with the Bowers Southern Dredging Company. He was its majority stockholder, its active directing head, and devoted all of his time to its operations (R. 11, 28). In addition to his association with the Bowers Company, Clark in 1921 and 1922 was a member of the partnerships of D. M. Picton & Company, Port Arthur, Texas; The Florida Dredging Company, Miami, Florida, and Megathlin & Clark, Miami, Florida. Megathlin & Clark and The Florida Dredging Company were engaged in the dredging business and D. M. Picton & Company in river and harbor work and jetty building. Respondent Clark took an active advisory interest in these partnerships whose work was mostly in connection with the work of the Bowers Southern Dredging Company (R. 11, 12, 28).

3. At the beginning of the War in 1917 the Bowers Company had many contracts to complete and began to experience financial difficulties. This finally resulted in its business being placed in the hands of a creditors' committee under which it was operated in 1921 (R. 12, 28). Clark became president of the Bowers Company in 1905 and continued in that capacity as long as it continued to operate. During 1921 and until the business was taken over in 1922 by the Clark Dredging Company, he served as managing operator of the company for the creditors. In 1922 the Clark Dredging Company was formed to take over the business and respondent was president of that corporation after its formation (R. 11, 12, 28).

4. The financial difficulties which beset the Bowers Company after the War started in 1917 resulted in its being unable to borrow money from banks without the individual endorsement of respondent, and in order to protect his investment in the company he, at various times, became endorser on the notes of the company. In 1921, as a result of such endorsements, respondent was forced to pay the sum of $68,000 for the company. This amount he took as a deduction for losses in his 1921 income tax return, and it was allowed by the Commissioner (R. 13, 28). In the same return respondent also reported a loss of $9500 incurred in the sale of stock of the Bowers Company, which was allowed (R. 13, 28).

5. In 1922, respondent being desirous of having some one with financial strength associated with the business of the Bowers Company, sold 1000 shares of the stock owned by him in the company, which he had purchased at a cost of $100,000, to George H. Nolan for $7,500. In his tax return for 1922 respondent took a deduction for the loss sustained of $92,500, which the Commissioner allowed (R. 24, 28).

6. The losses hereinabove mentioned being in each year in excess of the income, left the net losses, as above stated, which respondent has sought to deduct from his income of 1923 as net "business losses", coming within the provisions of section 204 of the Revenue Act of 1921.

Summary of Argument.

The "net losses" allowed by the act to be carried forward and deducted are those resulting from the operation of "any trade or business regularly carried on by the taxpayer."

The word "operation" is defined as "the course of action or series of acts by which some result is accomplished." *United States v. Somers,* 164 Fed. 259.

Business is that which occupies the time, attention, and labor of men for the purpose of a livelihood or profit.

The time, attention, and labor of the respondent Clark was devoted to the "business" of dredging, operated by a corporation of which he was principal owner and active directing head, and through partnerships, for the purpose of profit from his investment and in the form of salary. The business had been regularly and continuously carried on by him for a great many years.

Argument.

The respondent's net losses of 1921 and 1922 were net losses resulting from the operation of a "business regularly carried on" by him.

The accepted definition of business is that given in *Flint v. Stone-Tracy Co.*, 220 U. S. 107, 170, decided March 13, 1911, and is as follows:

> "Business" is a very comprehensive term and embraces everything about which a person can be employed. Black's Law Dict. 158, citing Peoples ex rel. Hoyt v. Tax Comrs., 23 N. Y. 242, 244. "That which occupies the time, attention, and labor of men for the purpose of a livelihood or profit." 1 Bouvier's Law Dict. p. 273.

Business is "that which busies or occupies the time, attention, or labor of one as his principal concern, whether for a longer or shorter time; employment, occupation; any particular occupation or employment; mercantile transactions in general; concern; right or occasion of making one's self busy; affairs; transactions." *Territory v. Harris*, 19 Pac. 286.

As stated in the case of *In re Mackey*, 110 Fed. 355, 358:

> The chief occupation or business of one, so far as worldly pursuits are concerned, is that which is of principal concern to him, of some permanency in its nature and on which he chiefly relies for his livelihood or as the means of acquiring wealth, great or small.

And as stated by the Board of Tax Appeals in *Baker v. Commissioner,* 17 B. T. A. 733, 737:

> In order to constitute a "net loss" within the meaning of the statute, it is not necessary that the taxpayer should sustain the loss in his principal business or vocation. The word "business" is qualified by the word "any". The taxpayer is entitled to this benefit where the loss is incurred in "any trade or business regularly carried on" by him. *Oscar K. Eysenbach,* 10 B. T. A. 716. And the term "business" is comprehensive. "Business" is anything "which occupies the time, attention, and labor of men for the purpose of a livelihood or profit." Citing authorities.

What then was the trade or business regularly carried on by the respondent? Since 1888, continuously through the years 1921 and 1922 here involved, he has been engaged in the business of dredging and supervising dredging operations off the coast of Florida and elsewhere. He was actively engaged in this particular business during all of these years, both individually and as the president, majority stockholder and active directing head of the Bowers Southern Dredging Company.

Respondent became associated with the Bowers Southern Dredging Company, as the record shows, in 1899 when it was organized, and continued so until 1922 when he organized the Clark Dredging Company to take over the business. He was president of the Bowers Company from 1905, managed its affairs, and looked after his investment therein, he being for a number of years the majority owner of the stock. When the business was taken in hand by a Creditors' Committee in 1921, he continued as managing operator, and was president of the new Clark Dredging Company which he formed in 1922 to succeed the Bowers Company. In addition to his interest in the Bowers Company, he was also a partner and took an active advisory interest in three other concerns engaged in similar work.

In an early decision of the Board in *Lloyd v. Commis-*

sioner, 8 B. T. A. 1029, it was held that an amount expended by the petitioner in an unsuccessful effort to secure a secret formula for the corporation of which he was president, under an agreement whereby he was to be reimbursed if the venture was successful, was deductible as a loss, and the Board made this further interesting conclusion (P. 1030):

> We are further of the opinion that the loss was "incurred in trade or business" in that the furtherance of the business of the company of which he was president was legally and logically his business.

The furtherance of the business of the company of which respondent was not only president but majority stockholder may likewise be considered as legally and logically his business, for as the Court of Appeals said (R. 29):

> Appellant accordingly was necessarily concerned with the financial conditions and difficulties which beset the business, and he was compelled by circumstances to indorse the company's notes in order to supply it with necessary operating funds. This action was not isolated or occasional but became part of the operation of the business, and helped to carry it on. It is true that appellant did not regularly carry on a business of indorsing notes for profit, but his indorsement of the company's notes was part of the business regularly carried on for the company. It is also true that appellant was not regularly engaged in the business of selling corporate stocks, but the transactions of that character appearing in the record can not be separated from the regular course of business of which they were part, and must not be considered as if wholly independent transactions.

In *Washburn v. Commissioner,* (C. C. A. 8) 51 Fed. (2d) 949, it appears that a lawyer who had organized a number of corporations and enterprises retired from law practice in order to give his entire time to these various enterprises in which he was heavily interested, four of which were tim-

ber holding corporations. In order to open up the timber lands of one of the companies he organized a railroad company, which built a railroad to the property. He was the principal stockholder therein, managed its affairs, and selected its officers and directors. He advanced the money with which to build the railroad and took back stock. In 1922 he sold the stock and sustained a loss which he sought to carry over and deduct in 1923. The Court summed up the situation of the petitioner as follows:

> Petitioner does not claim that he was engaged in the railroad business or that he was a dealer in securities. His position is that his occupation was the personal attention given to the management of the various enterprises in which he had investments for the purpose of making those enterprises successful and profitable; that to this he gave his entire time, and was doing a great deal more than merely guarding his investments; that the loss on the sale of the railroad was occasioned in carrying on his general avocation. (P. 952)

The Court, in reaching its conclusion that the petitioner's loss was one incurred in a trade or business regularly carried on, made this significant statement (P. 953):

> Much is said in argument as to petitioner being engaged solely in holding the securities of the enterprises in which he was interested, and that he was a mere investor receiving the ordinary returns of ownership. A party may have investments in corporate stock, have no particular occupation, and live on the return of his investments. That would not constitute business under the statute in question. *He may, however, take such an active part in the management of the enterprise in which he has investments as to amount to the carrying on of a business.* (Italics ours.)

The view taken by the Circuit Court of Appeals in the *Washburn* case, in the language quoted, and that of the Court of Appeals in the instant case, is in accord with the

decisions of this and other Courts in cases involving the question as to whether corporations are liable to the capital stock tax imposed on the privilege of carrying on or doing business. In those cases it has uniformly been held that where a parent corporation owning the stock of subsidiary corporations and receiving dividends thereon, takes an active part in the management and direction of the subsidiaries, it is carrying on or doing business. *Edwards v. Chile Copper Co.*, 270 U. S. 452; *Phillips v. International Salt Co.*, 274 U. S. 718; *Chevrolet Motor Co. v. United States*, 64 Ct. Cls. 211, certiorari denied, 277 U. S. 585; *Ward Baking Co. v. United States*, 66 Ct. Cls. 456, certiorari denied, 50 Supreme Court, 18.

In the *Edwards v. Chile Copper Co.* case the Court said, at page 455:

> The exemption "when not engaged in business" ordinarily would seem pretty nearly equivalent to when not pursuing the ends for which the corporation was organized, in the cases where the end is profit. In our opinion the plaintiff was liable to the tax. * * * The activities and situation must be judged as a whole. Looking at them as a whole we see that the plaintiff was a good deal more than a mere conduit for the Chile Exploration Company. *It was its brain or at least the efferent nerve without which that company could not move. The plaintiff owned and by indirection governed it, and was its continuing support, by advances from time to time in the plaintiff's discretion.* (Italics ours.)

The Bowers Southern Dredging Company was one of the instrumentalities through which the respondent Clark carried on the dredging business. He was its principal stockholder, president and manager, and devoted all of his time, attention, and energy to its affairs, for the purpose of profit. He was, to paraphrase the language of the court in the *Chile Copper Co.* case, its brains, the efferent nerve by which it moved, and the indorsement by him of its notes, which resulted in his loss, as well as the sacrifice of his

stock, were steps taken to energize the corporation, sustain its life or existence, and continue the business which was his principal concern as a means of acquiring wealth or profit.

The decision of the Board of Tax Appeals in the case of this respondent was adverse, the Board stating, with respect to his loss of $68,000 resulting from indorsement of notes for the Bowers Southern Dredging Company, that so far as the record showed these were the only notes ever endorsed by him for the company and there was nothing to indicate that acting as endorser or guarantor constituted a business or trade with him.

The Court of Appeals in reversing the decision of the Board points to several more recent decisions in similar cases where the conclusions reached by the Board are inconsistent with its conclusion in this case. They are *Anthony v. Commissioner*, 20 B. T. A. 5; *Averill v. Commissioner*, 20 B. T. A. 1196, 1199, and *Heller v. Commissioner*, 25 B. T. A. 259.

An analysis of the decisions in question will show that the situation involved in each instance is very similar to that in respondent's case. In the *Anthony* case, the business was the retailing of ready to wear furnishings for men, women and children. It was first a partnership and then corporations were organized. In the *Averill* case, the taxpayer was interested in many enterprises in various activities, all in corporate form. In the *Heller* case, the petitioners were stockholders in and managed and operated the business of several corporations engaged in retailing ladies' ready to wear clothing. In the respondent's case the business was that of river and harbor improvement, dredging and jetty building, operated through three concerns, in which he was a partner, and a corporation in which he was the principal shareholder, president and manager.

With equal force, it can be said, as in these three cases, if

that be the determining factor, that respondent used both capital and knowledge in the business of managing concerns engaged in the dredging, river and harbor improvement, and jetty building business.

The situation is probably even more pronounced in the instant case than in *Potter v. Commissioner*, 18 B. T. A. 549, decided in 1929 by the Board. Potter had been for a number of years interested in various hotel enterprises. He owned and operated the Clarendon Hotel at Sea Breeze, Fla., until it burned down. A corporation was formed for the purpose of building and operating a hotel of the same name on the same site. Potter acquired $100,000 of the $250,000 issued preferred stock and $275,000 of the $300,000 issue common stock of the corporation. He actively operated the hotel as managing-director for a salary of $3,000 per year. The corporation obtained a loan of $150,000 and as a consideration for making the loan the lender acquired 50 per cent of the outstanding common stock belonging to Potter. Subsequently the parties became involved in litigation, the outcome of which was the sale by Potter to his opponents of his stockholdings at a considerable loss, which loss the Board held to have been incurred in a trade or business regularly carried on by Potter. In both instances the taxpayer was interested as a stockholder and manager-director in an activity from which he earned his livelihood—Mr. Potter, in the hotel business, and Mr. Clark in the dredging business. Each sustained losses in the sale of stock in one of the enterprises with which he was connected and in assisting his corporation to obtain loans or working funds. They were not mere investors but made the business in which their funds were invested the subject of their personal and individual attention, receiving salary in addition to the return from the investment. Quoting from the opinion in the *Potter* case (page 553):

> The picture presented shows clearly that the investment and the personal management were closely re-

> lated, each dependent on the other, the two combined producing the income received by this taxpayer, and that the knowledge, experience, work and investment were all in respect to one definite and distinct line of business, * * *.

The fact that the respondent in endorsing the notes of the Bowers Southern Dredging Company and paying same and the selling of some of his shares of the stock to improve the financial standing of the company was, in addition to assisting and aiding his business in the several partnerships, safeguarding his investments by providing funds and financial assistance needed by the corporation, does not—to adopt the language of the Board of Tax Appeals in *Comrades v. Commissioner,* 21 B. T. A. 213, 215—stamp these activities as merely an incident of his service as an officer of the corporation or as merely incident to his ownership of the stock.

For other Board decisions dealing with the subject of losses incurred in trade or business regularly carried on, see:

Heaslet v. Commissioner, 23 B. T. A. 50;
Lovering v. Commissioner, 21 B. T. A. 1260.

CONCLUSION.

The facts in this case show clearly that the net losses sustained by respondent in 1921 and 1922 were losses resulting from the operation of a trade or business regularly carried on by him within the intent and meaning of Section 204 of the Revenue Act of 1921, as construed by the Court of Appeals.

The judgment of the Court of Appeals should, therefore, be affirmed.

Respectfully submitted,

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